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# FARMERS' NEWSLETTER
## Cotton

December 81/C-20

### Most Cotton Since 1953

The largest U.S. cotton crop in 28 years is coming out of the fields. Growers are likely to harvest about 15.6 million bales on the strength of an average yield of 543 pounds an acre.

The current recession, however, is limiting demand for this bumper crop. Deeply affected are prospects for cotton mill use, forecast at 5.9 million bales--the same as last season, but down from earlier estimates.

Less buying by manufacturers and retailers, a huge excess of cotton textile imports over exports, and the effects of high interest rates on inventories have kept mill use at the low rates of late last season. Little change is likely until well into 1982 when consumer spending may begin to perk up.

U.S. exports are now forecast at 7 million bales, 1.1 million above a year ago. The rise reflects estimated increases in mill use and some stock rebuilding in foreign countries, as well as large U.S. supplies that will hold prices below those for foreign cotton. China, Japan, Korea, and Taiwan will probably take 70 percent of these exports. But prospects could change if:

- a worsening U.S. recession weakens demand for cotton fabrics, limiting foreign mill use in early 1982.
- the USSR and China decide not to build stocks as anticipated.
- the Central American harvest in early 1982 is smaller than expected.

### Stocks Depress Prices

Because this season's production increase is much larger than the likely rise in total use, stocks next Aug. 1 are expected to be 5.5 million bales--more than double this year's carryin. As the stock forecast increased this summer and fall, farm prices fell.

At planting time, some farmers were able to contract upland cotton at an average price of 70-75 cents a pound, but by September, the price fell to 58 cents. A slight rebound in November to about 63 cents reflected delivery of forward contracted mid-South cotton and heavy Arizona and California sales. During November, spot and futures prices again retreated as stock prospects increased.

Eligible farmers will receive a deficiency payment this season if the 1981 average farm price is less than the target of 70.87 cents a pound. Although farm prices during the first half of the year exceeded the target, this fall's prices probably will be low enough to pull the calendar year average well below target.

The same payment rate--the difference

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The next cotton newsletter is scheduled for early March.

**STOCKS TO DOUBLE**

| Crop year beginning August 1 | 1979 | 1980 | 1981[1] Projected | 1981[1] Prob. variab. |
|---|---|---|---|---|
| | ---Million 480-lb. bales--- | | | |
| Beginning stocks | 4.0 | 3.0 | 2.7 | |
| Production | 14.6 | 11.1 | 15.6 | ± 0.2 |
| Total supply[2] | 18.6 | 14.2 | 18.3 | ± 0.2 |
| Mill use | 6.5 | 5.9 | 5.9 | ± 0.3 |
| Exports | 9.2 | 5.9 | 7.0 | +0.9 |
| Total use | 15.7 | 11.9 | 12.9 | ± 1.2 |
| Ending stocks[3] | 3.0 | 2.7 | 5.5 | ± 1.4 |
| | ---Cents per pound--- | | | |
| Farm price | 63.4 | [4] 76.4 | (5) | |
| Target price [6] | 57.70 | 58.40 | 70.87 | |
| Loan rate [6] | 50.23 | 48.00 | 52.46 | |

[1] As of December 11, 1981. Chances are about two out of three that the outcome will fall within the implied ranges. [2] Includes imports. [3] May not add because of rounding. [4] Average to April 1, 1981. [5] USDA is prohibited from publishing cotton price projections. [6] For grade 41 staple 34 cotton.

between the target and 1981 average farm price--applies to all farmers regardless of their actual selling price. The payment rate, program acreage, and program yield will determine each producer's total payment.

Keep several factors in mind when forming price expectations for early 1982:

- Demand. An early rebound from the recession or increased exports could boost prices.

- Seasonality. As shown in the table to the right, prices over the past decade have often increased in the first half of the year.

- Acreage. USDA's Prospective Plantings report on February 18 will indicate growers' 1982 plans. Prices could strengthen if intended acreage drops.

- Government policy. The farm bill covering the 1982-85 crops may be enacted soon. Loan rates, target prices, and other provisions could influence the price outlook.

- Loan use. Heavy loan placements could support prices in early 1982, but depress them later when loans are redeemed.

## Marketing Options

Farmers are using or considering these options:

1) Put cotton under loan.
2) Put cotton under loan and hedge by selling futures contracts.
3) Sell cotton now.
4) Sell cotton now and buy or sell futures contracts.

By choosing options 1 or 2, you postpone a cash sale and use the cotton as collateral for a CCC nonrecourse loan. Use option 1 if you think prices will rise enough during the loan period to offset carrying costs. However, the value of the stored cotton changes as the cash price changes, so under this option you are a speculator--you take a price risk.

The risk can be reduced by hedging the stored cotton, option 2. This protects you from falling prices, but it also prevents higher returns should prices rise substantially.

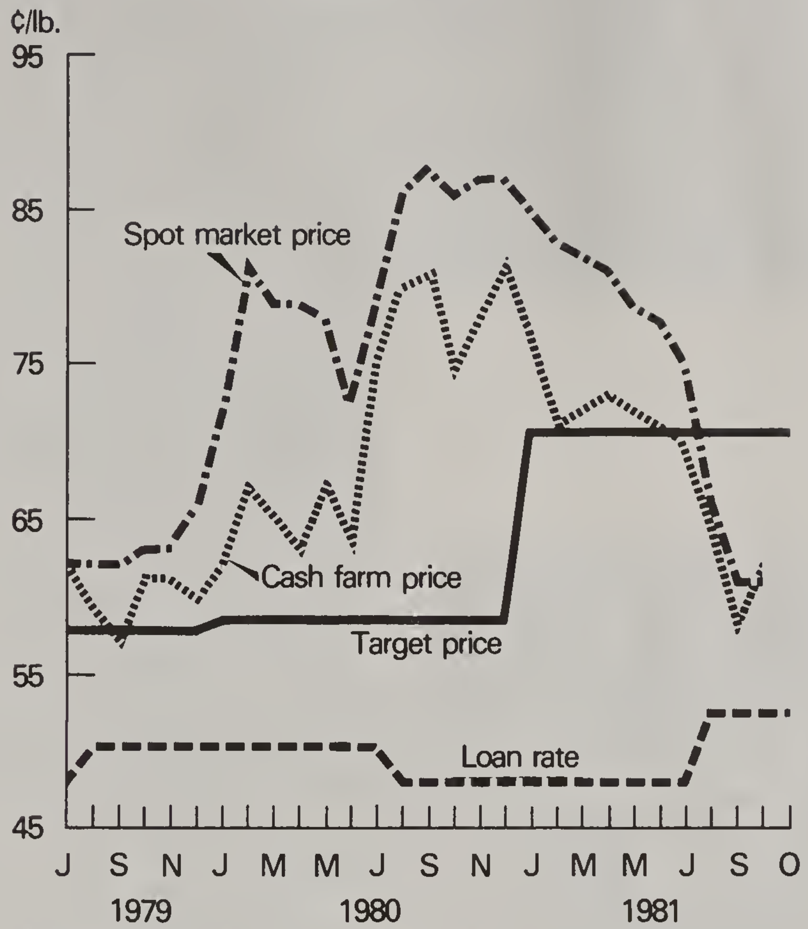
Option 3 gets you the full market price now, avoids storage costs, and

**PRICE CHANGES OVER THE PAST DECADE[1]**

| Period | Number of times prices went Up | Down |
|---|---|---|
| July to Aug. | 6 | 4 |
| Aug. to Sept. | 7 | 3 |
| Sept. to Oct. | 5 | 5 |
| Oct. to Nov. | 6 | 4 |
| Nov. to Dec. | 3 | 7 |
| Dec. to Jan. | 5 | 5 |
| Jan. to Feb. | 7 | 3 |
| Feb. to Mar. | 6 | 4 |
| Mar. to April | 8 | 2 |
| April to May | 8 | 2 |
| May to June | 5 | 5 |
| June to July | 7 | 3 |

[1] Marketing years 1971/72 - 1980/81.

**FARM PRICES DOWN AGAIN**




Farm: U.S. average. Target and spot: grade 41, staple 34.

ends further marketing decisionmaking.

Option 4 does all of these too, but also makes you a speculator. It is chancy; there are brokerage costs, price risks, and a deadline--you must close out your position by the time the contract expires. Because of these problems this option may not be attractive. So, let's discuss the first three in more detail.

**Use the Loan . . .**

Check with your ASCS office if you wish to place your cotton under a CCC loan this season. The national average loan rate is 52.46 cents a pound, but varies by quality and location. Loans are available until May 31, 1982. The loan matures the last day of the ninth month following the loan transaction. CCC loans may be redeemed at any time. Renewal is possible for an additional 8 months in most cases, provided prices are not unusually high.

Interest is 14.5 percent for loans made through January 31. However, on February 1, the rate may change to more accurately reflect CCC costs of borrowing money from the U.S. Treasury. Such a rate change would be announced in late January.

While the cotton is under loan, carrying charges mount. Assuming a loan value of 53 cents a pound and a cash price of 58 cents, monthly carrying costs would include about 0.6 cent for CCC interest, 0.3 cent for storage, and 0.1 cent for foregone interest that could be earned on the difference between the cash price and loan rate. Thus, total carrying costs are about a penny a pound per month.

It may be advantageous to hedge stored cotton if differences between futures prices in successive months exceed carrying costs. This allows you to fix your return. For example, suppose cash prices have fallen when it is time to remove your cotton from storage. You now sell it at a lower cash price, but futures prices will also have dropped.

Because you can offset your futures contract by buying lower-priced futures, you make up on the futures market what you lose on the cash market. But, you must take into account brokers' fees, margins, and the risk that the basis, or difference between the cash and futures prices, will widen in coming months.

In early December, futures were 62 cents a pound for December delivery and 67 cents for July. The market was willing to reward you 5 cents a pound to carry cotton from December to July--slightly less than average carrying costs. Adding the other costs, such as commissions, indicates that a hedge, on average, would lock in a loss.

However, prices change and if hedging stored cotton looks more favorable in the near future and you want to consider it, see your broker.

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## . . . Or Sell Now

Selling now makes storage costs someone else's problem. The cash you receive can be invested at relatively high interest rates or used to pay off bills that charge interest. The big disadvantage in a cash sale is that you might earn less than using a marketing alternative. A little homework can help you make an informed choice.

## Cash Vs. Loan: An Example

Consider an early December cash sale versus placing cotton under a 6-month loan. If the current gin price is 60 cents a pound, then by early June, a cash sale yields:

| | |
|---|---|
| 60.0 cents | Sale price |
| 3.6 | Earned interest (12%) |
| 63.6 | On account June 1982 |

The interest is income earned by investing returns from the sale at 12 percent. Or possibly, more could be saved by paying off bills and avoiding interest charges that probably exceed 12 percent.

To determine what you have on account in early June using the loan, you need to estimate June's cash price. For this example, let's choose the June price to be a "break-even price"--it's the price that must be reached if storage is to provide the same return as a current cash sale. If total 6-month storage and handling costs are 4 cents a pound, the breakeven cash price is 68.2 cents, and the balance sheet looks like this:

| | |
|---|---|
| 52.5 cents | Loan |
| 3.2 | 12% earned interest |
| 68.2 | June cash price |
| 123.9 | Subtotal |
| 52.5 | Less loan principal |
| 3.8 | Less 14.5% CCC interest |
| 4.0 | Less storage cost |
| 63.6 cents | On account June 1982 |

Your breakeven price probably differs from this example because your farm price, loan rate, market interest rate, and other details differ. Also, this example doesn't use the possible tax deduction for the interest paid on the CCC loan. However, you can use this method to figure your own breakeven price for any month in the future. If you think the cash price will not reach the breakeven price, selling now is a better strategy.

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